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## WHAT THE FEDERAL RESERVE SYSTEM HAS DONE

Two and a half years of experience in the operation of federal reserve banks is not a period of sufficient length to enable the careful student of banking institutions to form a final judgment concerning them. The banks, although technically in existence for about thirty months, have been fully organized and in operation for a much shorter period. They may perhaps be said to have had a real operating life of from eighteen months to two years. But even that length of time has not afforded the test that would have been furnished at almost any other period in American financial history. The unexpected and drastic changes in financial and commercial relationships due to the European war have altered underlying conditions, have produced developments in foreign trade and in banking that could not have been predicted, and, coupled with the unusual and extreme financial expedients adopted by foreign governments, have subjected the American market to highly artificial conditions. For all these reasons, a judgment of the success of the federal reserve system and a prediction based thereon, if furnished at this time, must be accepted only subject to very grave qualifications. Some of these will appear later in the present discussion; others no doubt will suggest themselves to the reader without being pointed out. The conclusion arrived at must in any event be regarded as tentative and as being stated entirely in terms of existing conditions—that is, as indicating a comparative judgment regarding the value of the federal reserve banking system in contrast to the conditions which would have existed had it not been organized.

### I

Certain obvious elements in the federal reserve system may first be enumerated and disposed of, more as a matter of record than as contributing much to the discussion. First of all, the federal reserve system has proved its practicability and has shown that it can be a successful “going concern.” This statement, now so widely if not universally conceded, was, as will be remembered, sharply combated at the time of the passage of the Federal Re-

serve act and for a good while afterward. The doubt it implies probably lingered in the minds of many who were hopeful of the success of the system, and may even have troubled some of those who firmly believed in its possibilities. The cruder fears then expressed—that the reserve banks would be controlled by political or unbusinesslike considerations both as to personnel and as to their operations—were promptly proved without foundation, and even those who have been most anxious to find traces of corruption, gross nepotism or genuine inefficiency in the banks, have been unsuccessful. The present writer has on a former occasion pointed out that at the beginning some of the banks were probably over-staffed as a result of the inability to forecast the exact scope of the business to be undertaken. The terms of the law itself make unavoidable a heavy overhead expense, and it may be conceded to those who seek to find a basis for criticisms that probably all of the banks if commercially operated could be conducted on a somewhat lower level of expense than they now are. This does not mean that there has been extravagance or carelessness in management but merely that the conditions under which the banks have been organized, the terms of the law creating them, the necessary safeguards involved in their handling of funds, and other considerations which necessitate the maintenance of elaborate records and complete control of every operation, have made them expensive institutions. That they have been too expensive for the service they have rendered, few contend; and the fact that during the year 1916 the banks, besides covering all expenses, earned 5 per cent net upon their capital, while maintaining themselves in exceptionally strong condition, should effectually terminate the discussion as to whether they can be made to “pay” or not. The management of the Federal Reserve Board at Washington has been successful in moulding the system into a uniform shape, and relationships between the board and the banks have produced so little friction that even a rather severe critic thoroughly familiar with the inner workings of the administrative organization of the system would probably concede success in this branch of its activities. The expenses of the board, including all salaries, have aggregated less than \$220,000 a year, and mark it as one of the least costly government enterprises of the sort now in existence.

Again, it is to be noted that the currency supplied by the system has been readily available, satisfactory to the public and to

the banks, and abundant in amount, so that the "emergency currency" aspect of the so-called "banking reform problem" appears to have been fully dealt with. This brief sketch of the more obvious facts regarding the working of the system may be summarized in the statement that "success" in the superficial sense of the term has unquestionably attended the enterprise, and the statements made are so little open to controversy that they may almost be regarded as axiomatic.

## II

As there was never any reasonable room for doubt regarding the success of the federal reserve system in the sense already described, granting honesty and fair ability in putting it into operation, so there need be no assumption of exceptional credit and no claim to more than ordinary achievement growing out of what has been done in this regard. It is rather with the subtler workings of the system and with its effects upon banking in the scientific sense of the term that the student is concerned. He will look for an answer to the questions whether the system has in reality improved and strengthened the banking condition of the United States in the way that was expected and hoped by careful analysts of banking problems, and he will inquire whether those matters in which the federal reserve system constituted a new and original departure from the ordinary principles laid down in what was previously included under the head of "banking reform" have been justified. To these questions we may now address our attention.

Perhaps the most fundamental problem affecting the whole system is that which grows out of the so-called "regional" type of organization. The Federal Reserve act while in its early stages was bitterly assailed not only by those who have continued to complain of its regional character but also by many who are now members of the system created by it. It was then asserted that the central or coöperative banking principle could not be successfully worked out upon a district plan; that no national discount market could be brought into existence under such a plan; that the policies of the several federal reserve banks could not be harmonized or adapted to one another sufficiently to bring about the necessary community of action, and that the existence of the several districts would render the various banks so weak, dependent and inefficient as to deprive them of real strength. These opin-

ions were never accepted by the less partisan of those who shared in banking discussion prior to the year 1914, and would not be conceded now, even without experience in operation. Conclusions drawn from the two and a half years of experience with the system must, as already suggested, be modified by the fact that conditions have been very unusual. Nevertheless, we may put forward with assurance certain definite ideas upon each of these points. The reserve banks have beyond any question been operated as a unit. Their discount rates have been substantially similar, bearing in mind differences in local conditions, and there has been little or no difficulty on their part in meeting the local conditions that called for remedial action. The Southern reserve banks, while not equal in capitalization and resources to the others, have been able to render marked assistance to the banks of their own communities, and through them to the borrower, while their influence has been in the direction of moderating and harmonizing interest and discount rates to such a degree as to bring decided and generous recognition of their work not only from technical men but from the public at large. If a section of this public is at times inclined to praise the reserve banks because of a belief that to the work of these institutions may be attributed increases in the prices of cotton or other staples, it yet remains true that much of the recognition accorded to their efforts has been more discriminating. The Southern agricultural communities have found that the stringency of the "crop moving period" has been greatly diminished, and that an appreciable part of this benefit is attributable to the working of the reserve system. While it has never been necessary thus far for one reserve bank to draw upon another for aid through rediscounts, the machinery for extending such aid is always available, and there is probably no informed person who doubts that had such aid been required it could and would have been promptly rendered. It is, therefore, fair to conclude that the country has derived from the federal reserve banks organized upon the regional or district plan all of those benefits in the way of accommodation, adjustment of rates, and equalization of banking capital that they could have had from a central bank with branches. The statement that a central bank with branches would have done the same work very much more cheaply is scarcely borne out by the limited experience of the reserve system thus far in the matter of branches, and is still less supported by the evident logic of the facts in the case. Ex-

perience has daily demonstrated that the various communities desire local institutions and that a central bank would have had to establish branches nearly as costly in their operation as the individual federal reserve banks is a conclusion that can hardly be escaped. Some saving in overhead expenses could probably have been made by such an institution and a slight saving in the cost of note issue could probably also have been secured, but beyond this it is difficult to see any advantage in the one plan over the other as relating to economy of administration.

On the other hand there seems to be no reason to doubt that the regional or district plan has operated as effectively in the direction of a discount market as a central bank would have done. It was a commonplace among those who opposed the new system to say that the discount market could not be secured save through a bank organized upon highly centralized principles. Just how far this "discount market" may be said to have been brought into existence we shall inquire more fully at a later point. The question here at issue is whether or not the district type of organization has been in any way different in its effect upon the discount market from that of the central bank. The answer would seem to be decidedly in the negative. Several considerations may be cited in support of this view. In the first place, there has been close coöperation between the federal reserve banks in most matters. In other ways, moreover, close coördination of work has been obtained. Reference has already been made to the adjustment of discount rates to one another upon a close working basis, but this is only one of several examples of coöperation. If it be said that this coöperation and coördination is merely another way of approximating to a central bank plan of organization and that it differs from the latter only in being less efficient and more clumsy, the reply must nevertheless be ruled out of account. The question is not whether the federal reserve system can or could successfully substitute something new for the methods of central banking but whether it can make use of those methods. If it has done so, those who were disposed to contend that it could not succeed for lack of them must own themselves in the wrong.

The issue, however, is far more important than that of proving whether this or that contending group was or was not right; it is a question whether the methods of the federal reserve system looking to the establishment of a definite discount market have been efficient and satisfactory, and to this the reply must

be on the whole in the affirmative. Interest rates have undoubtedly been stabilized and rendered more uniform than in the past, while the banks have been able to act as a unit in their purchases of paper and investments. Indeed, some might consider that more criticism should be visited upon the closeness of this coöperation, than upon the alleged clumsiness of the expedients employed. There is general agreement that the district plan of organization has resulted in bringing the reserve banks of the several districts considerably closer to the communities in which they are located than could have been true had these banks been mere branches of a central organization. This is not a partisan or one-sided assertion, but is a generalization from authoritative expressions made by many persons including not a few of those who formerly entertained the opposite view. While there has been criticism of the method of electing the directorates of the several banks, and while it has been and is frequently stated that these directorates are not satisfactorily representative of the banking and business communities in which they are located, owing to the preponderating power given to the smaller banks through the equality of voting strength ("one bank, one vote") provided in the act, combined with the singular circumstance that many country banks do not care to exercise their franchise, it yet remains an admitted fact that the banks are regarded by their several communities as being in a very direct sense their own institutions, controlled by them, responsive to their needs, and far more truly representative of local requirements, as already stated, than the branches of a central bank could have been.

### III

It was apparent from the initiation of the federal reserve system that its essential success would depend very largely upon its being able to reform the commercial paper of the country. It is not now necessary to consider the lines along which this reform was called for, since recent banking discussion has made the whole subject familiar to all students. As is well known, the banking paper of the United States has developed in a predominating degree upon the "single-name" basis, as opposed to the "acceptance" or "two-name" basis adopted in foreign countries. While there have been voices, some of them influential, that protested against the attempt to substitute two-name paper for single-name, the general drift of discussion in recent years has been toward two-name paper,

on the ground that it represented a more scientific, logical, and safe method of doing business. Perhaps the very latest development in opinion since the organization of the federal reserve system has been that whereas the single-name plan has merits of such distinct nature as to insure its continued existence, the two-name or acceptance plan is needed as an auxiliary so that in the future the paper of the United States may be regarded as prominently containing elements of both classes. This eclectic view seems likely to be the sound one, although it safely avoids committing itself on the question how far the acceptance paper is to displace the single-name variety. What is clear is that one test of the federal reserve system must inevitably be the extent to which it has facilitated or assisted the growth of this acceptance paper. Has it done so in any adequate measure and can it in the future increase the degree of its success in that regard? The Federal Reserve act as originally passed gave the Federal Reserve Board authority to define commercial paper eligible for rediscount at federal reserve banks, and the board in its initial stages desired to discriminate in favor of the two-name paper, though it never went so far as to commit itself definitely in that way. Single-name paper has always formed the bulk of that discounted by the federal reserve banks, and this has been apparently the result of necessity. The Federal Reserve act, however, clearly intended to stimulate the "bill of exchange" whether that of the commercial enterprise or of the banker, and the board has, therefore, very properly endeavored by favoring rates and by special regulations to encourage the development both of the commercial bill of exchange (designated by it as the "trade acceptance") and of the bankers' accepted "bill of exchange."

Despite these efforts, the quantity of trade acceptances or commercial bills offering in the New York market has been lately described by a practical banking authority very friendly to the trade acceptance as "negligible." Although the amount of this paper rediscounted at federal reserve banks has been extraordinarily small, investigations carried on for the purpose of ascertaining how far the new type of paper was being used have shown that it was gaining ground, and in the autumn of 1916 a committee of federal reserve agents charged with the duty of investigating the subject, compiled from easily available sources a list of seventy more or less influential firms and corporations which had definitely adopted it. This list, it is understood, has been



considerably extended since that time. In some parts of the country no progress whatever seems to have been made, due to the fact that local concerns were not dependent upon the banks and had no trouble in conducting their business relations upon the open account system. In others, however, very decided progress is clearly being attained, and the volume of trade acceptances presented to the banks is evidently no measure of the volume in existence. For evident reasons, the trade acceptance is a desirable means of closing an account, even if the concern which sells the goods is not under the necessity of discounting its paper at a bank. On the commercial side, then, it must be said that the federal reserve system has only begun the development of the particular kind of paper which is necessary to the satisfactory upbuilding of the enterprise. More attention has been given to the bankers' acceptance than to the trade acceptance, and apparently more success has been attained in connection with it. The original federal reserve act permitted the use of bankers' acceptances only in financing the exportation and importation of goods, a limitation at first understood to apply to foreign trade between the United States and other countries, but extended by the Federal Reserve Board to cover international trade between any countries. Later (on September 7, 1916) permission was granted for the acceptance by banks of bills growing out of domestic trade provided that the latter were documented in every case. Today, therefore, the bankers' acceptance may be drawn either as a foreign or as a domestic bill. No satisfactory data are as yet available concerning the development of the domestic acceptance, and, whatever the volume in existence may be, it is probably small. The foreign bankers' acceptance has had about two years for development, and we may roughly estimate that at the present time the acceptances of all American banks, whether members of the federal reserve system or not, are about \$250,000,000—\$300,000,000. Every member bank has the right to accept such paper up to 50 per cent of its capital stock, and the Federal Reserve Board has granted to forty-four banks the power to accept up to 100 per cent. The following brief table shows the distribution of these acceptances in an approximately accurate way:

## ACCEPTANCE LIABILITIES OF BANKS AND TRUST COMPANIES.

In Greater New York					
National banks	.....	March 5, 1917	\$50,120,900	Nov. 17, 1916	\$61,359,700
Trust companies	.....	Feb. 28, "	102,240,100	Nov. 29, "	89,005,400
State banks	.....	" " "	6,546,200	" " "	3,442,300
In Philadelphia					
National banks	.....	March 5, 1917	8,848,700	Nov. 17, 1916	8,640,000
In Maryland					
State banks and					
trust companies	.....	Dec. 27, 1916	3,973,100	Nov. 17, 1916	3,308,100
All other national banks	" " "		38,917,000	" " "	34,279,000
Total reported	.....		\$210,646,000		\$200,034,500
All other (estimated)	.....		50,000,000		
Total	.....		\$260,646,000		

On the surface, this progress in the use of the bankers' acceptance may be regarded as satisfactory. It may be true, as some critics state, that the development is "abnormal," and that had it not been for the sudden advent of the United States in the international market as a "creditor country," no such use of the bankers' acceptance could possibly have been attained. This question is one of those "pleas of confession and avoidance," to which no attention need be paid. The fact is that the development has occurred and that it has been rendered possible by the existence of the federal reserve system. How far, however, has it been real? Very early in its history the Federal Reserve Board was obliged to meet the inquiry whether an acceptance must be based upon a commercial transaction in the narrow and restricted sense of the term—that is to say, whether the acceptance must represent an actual sale of goods corresponding to that particular drawing and to be settled for at maturity. There were evidently two questions involved in this matter: one, whether each and every acceptance as such must represent a transaction, an actual shipment, or whether it might represent merely a part of a general operation; the other, whether the paper so given must be positively regarded as an obligation demanding settlement at maturity or whether it might be "renewed." It is evident that the question really at stake here was whether the bankers' acceptance must or must not be regarded as a genuine commercial bill. The Federal Reserve Board ruled that there was nothing to prevent a bank from entering into a contract establishing a line of credit in behalf of given concerns, and that when this line had been established, acceptances (provided they did not overrun the total credit thus established) could be renewed or replaced by new issues for a designated period. The acceptance thus really tended to be-

come a finance bill, and a considerable volume of renewal acceptances was promptly placed upon the market by bankers who were engaged in financing the operations of concerns desirous of supplying goods to foreign governments. It is not possible to state exactly the amount of these renewal acceptances, but the volume placed on the market up to January 1, 1917, was probably in the neighborhood of \$125,000,000. The amount held by the federal reserve banks at its maximum was about \$30,000,000, a sum since reduced to less than one half its former amount.

These renewal acceptances cannot be regarded as a normal or perhaps as a wholesome element in the financial market. The idea of renewal is itself repugnant to the conception of the commercial bill, and when we recognize that perhaps one half of the total acceptances available in the American market today are of this non-commercial kind, our progress in the development of the bankers' acceptance plainly appears to have been much less than had been supposed. That there has been real progress, that the new method has struck its roots, that it will in future not merely hold its own, but develop, there is every reason to believe, and this must be regarded as one of the hopeful and useful results of the federal reserve system up to date. The discount market in so far as based upon standardized commercial paper, authenticated by the acceptance of houses so well known as to render paper marketable, exists today in the United States, but exists only as a nucleus surrounded by a somewhat nebulous and uncertain body of possibilities. There remains, therefore, the task of developing and confirming the real practice of acceptance by American banking houses upon a regular business basis, not the result of war or of exceptional export conditions, but worked out in consequence of legitimate commercial demand, coupled with the application of active banking enterprise. Exactly how far and how soon this will be possible, it must be admitted still remains to be ascertained. The failure of American banking houses to enter the foreign field with any degree of activity in so far as the establishment of branches or regular agencies abroad is concerned, is not an encouraging symptom, although, of course, the development of the acceptance market may proceed upon more or less satisfactory lines independent of this active participation in foreign trade.

## IV

One of the fundamental ideas that were embodied in the Federal Reserve act as originally drawn was that of providing a check collection system that would be national in its scope. The considerations which impelled the framers of the Federal Reserve act to incorporate this provision were both theoretical and practical. We need not here discuss, however, the theoretical aspect of credit media in their relation to the currency, but may for present purposes confine attention wholly to actual results as exemplified in practice, through the application of the Federal Reserve act. The bad practice whereby checks were maintained outstanding for large amounts and for long periods of time in order to enhance the apparent holdings of various banks, and the coördinate practice whereby holders of such checks were made to pay exorbitant and varying sums for the conversion of their claims into actual money had been recognized by the framers of the act as unwarranted handicaps to industry and as blemishes upon an otherwise promising system of business settlement. They were, moreover, regarded as germs of unsoundness, likely to produce harmful growths when stringency or panic brought bad conditions leading to a suspension of specie payments, which usually rendered the great "float" of checks and drafts uncollectible in cash. Upon the practical side it was recognized that under the old system of reserves, reserve balances in cities had been made to carry the load of collections, that is to say, had been made to serve a dual purpose—that of a reserve balance and that of a collection basis.

It was noted that this reserve consisted in no small degree of uncollected items which had been deposited with the banks and had as a matter of courtesy on the part of the Comptroller of the Currency been allowed to count as reserves. It was believed that in practice the member bank must be furnished with the same service by the reserve bank that it had in the past received from other member banks acting as reserve agents, and that this service on the part of reserve banks would tend very strongly (if properly performed) to reduce the amount of the outstanding "float" and to place the collection system upon a sound and effective footing.

We shall not find it necessary at this point to rehearse the history of the long struggle that has attended the effort to make the collection requirements of the act effective. Enough has been said when it is pointed out that from the beginning the application

of the collection system was met with determined opposition from a great variety of sources, and that the disposition on the part of the Federal Reserve Board to leave the question to the various banks to be worked out as a matter of practical experience and adjustment was not a success. As the time for the final transfer of reserves has drawn near (November 16, 1917), it has, however, been appreciated more and more strongly by wise bankers that an effective clearing and collection system ought to be introduced and made actually operative before the time of eventual transfer when the reserve balances with city banks would no longer count as reserves should arrive. Hence, the action of the Federal Reserve Board in adopting in the early summer of 1916 a compulsory system of clearings and collection. Inasmuch as the items were drawn, in the nature of things, not only upon other members but also upon non-members it was early perceived that the success of the plan would depend upon obtaining the consent of non-members to its application. That enough non-members have accepted the plan to make the total number of assenting banks about 15,000 (as against some 7,625 regular members of the system) shows that the plan has thus far met with very distinct success. In effect, it amounts to nothing more than the undertaking of check collection at par, with deferred book credit, a moderate charge for handling the several items being made to the banks that deposit them.

The operation of this plan of clearing and collection has materially reduced exchange charges in many parts of the United States. Various large business houses testify that they have made savings of 50 per cent of their annual exchange charges. This saving has been effected without the sacrifice of legitimate business by any bank. There is no truth in the constant statements that banks are compelled under the plan to make their checks good at a great distance from home. The ruling of the board has merely been that checks drawn upon a member bank must be paid for by acceptable exchange remitted by the member bank to the federal reserve bank, but that in the absence of such exchange the *reserve bank* will pay the cost of transmitting currency. At one time recalcitrant banks were informed that non-adherence to the system would mean that checks would be directly presented to them and collected in currency at their counters through the Post Office Department, but this has not been found necessary thus far. About all that can be said, then, is that the collection system of the

Federal Reserve Board by enlisting, in some cases, the services of the express companies, as check collecting agencies has up to date prevented banks from enforcing a discount upon their own checks and has compelled them to meet these obligations over their counter at par or to adopt a policy which was equivalent thereto.

This is a long stride toward the establishment of better, fairer, and more businesslike conditions of check settlement in the United States than have ever in the past existed. It is the first time that any scientific, unifying effort has been made in the direction referred to. One result of the work done is to bring about a greater approach toward uniformity in clearing house rules and in many other ways the indirect consequences of the attempt have been as beneficial as its direct results. Very distinct credit should be given to the federal reserve system as a whole for what it has accomplished in this particular, even while the admission is made that it has not yet gone the full length that some had expected, or attained as yet the results that may reasonably be expected at a later date.

In this connection it is appropriate to note that the progress in transferring reserves from city banks to federal reserve banks has been steady and has occurred without the slightest shock to business or banking operations. One reason for the extension of the time required for this transfer over what was practically a three-year period was found in the constant predictions that the transfer would cause severe stringency. Whether as a result of the large importation of gold into the United States or for other reasons, such stringency has at all events not materialized, and the final transfers, if ordered, could be made without the necessity of shifting any actual cash from the large city banks to the federal reserve banks. The development of a satisfactory check collection system has undoubtedly gone far toward reconciling the wiser bankers of the country to the transfer of reserves, while the admission is now very general that the new system without an adequate reserve requirement could not possibly have succeeded.

## V

In one phase the operation of the federal reserve system thus far must be considered decidedly incomplete. Most of the bills which preceded the Federal Reserve act had made a more or less elaborate provision for foreign banking, authorizing the establish-

ment of branches abroad and in other ways contemplating the upbuilding of American business elsewhere. This need was an obvious necessity, for American banking has nowhere been so inadequate as in its cultivation of the foreign field. As will be remembered, the Federal Reserve act, following the lines laid down by the discussion of the past fifteen years, had likewise made provision for foreign branches of American banks, subsequently supplemented by an amended provision which authorized the creation of foreign banks whose stocks should be held by groups of member banks, while it also made provision for the acceptance system already discussed. We have seen that the acceptance system has been artificially implanted in the United States and has attained a certain growth, but that its future must eventually be determined in no small degree by the action of American bankers in entering the foreign field. It must be admitted with regret that thus far very little progress in this direction has been made. American bankers have taken the foreign business that was automatically transferred to them or which came to them by reason of the lower rates of our domestic market, but they have shown comparatively little active interest in foreign banking as such.

We must conclude, therefore, that the banks of the country have not gone actively into the task of preparing themselves for the struggle to retain our foreign trade after the change of conditions which all admit must come when European conditions materially alter, and when competition is restored to something like its former intensity. The federal reserve system has made a beginning by undertaking preliminary arrangements looking to the designation of foreign agencies intended to assist in fulfilling the purposes of the system in so far as these relate to foreign operations. We need not, however, insist upon the fact that the federal reserve system has a purpose which is essentially different from that of ordinary commercial banks, and that whatever it may do in promoting our relations with foreign countries and in aiding in the general plan to promote the welfare of the American discount market, it cannot perform the task which only strong commercially organized institutions can fulfill—that of exploiting and developing the foreign market in the interest of our own business community.

It is to be feared that some of our bankers look at this question as if it were a question of immediate profit solely. They are inclined to inquire into the possible profits to be gained by the estab-

lishment of branches and connections abroad, as if it affected only them and the welfare of their institutions. The question is, however, a good deal broader than this, since it involves the whole matter of retaining our trade and developing it in markets other than our own domestic fields. The business man will not be able under existing conditions in trade and industry, to carry on the campaign alone. He must have that powerful assistance which only the banker can afford, and this cannot be rendered without special organization and coöperation for foreign trade. There are two methods by which such effective coöperation can be accomplished: one, the actual establishment of bank branches abroad; the other, the establishment of connections with some institution which will faithfully and earnestly represent the interests of our own bankers and business men in those foreign countries.

We have long known that England's powerful hold upon the trade of South America and the Far East was not due to any innate fondness on the part of the people of those regions for Great Britain or her citizens, but was due to the fact that British banking institutions stood ready to facilitate the movement of goods to those countries, while they also stood ready within reasonable limits to assist in the development of the resources of those countries, and in the exportation of their products to Great Britain. The progress which has been made in recent years by German bankers and business men in competing with Great Britain and her representatives, has been due to Germany's recognition of the essential basis for British trade, and her adoption of similar modes of getting and controlling business. The real question in the whole matter is: Do we want to continue our present control of foreign trade, or are we content to return to the foreign trade situation which existed before the European war? If we do in fact believe that benefit comes to the country from the maintenance of a strong and well-diversified foreign trade, it will be necessary for us as a nation to adopt those measures and methods which experience has shown to be requisite.

In order to deal with foreign countries successfully we must not only sell but buy. We must do more than this. We must hold out the help necessary to enable our own business men to place their goods on foreign markets with success and at reasonable cost, and we must enable shippers in this country to export without unreasonable sacrifice. Moreover, we must, if we wish to



create a permanent and growing foreign trade, aid producers and shippers abroad by every legitimate means in our power, to increase their output, and to market it under favorable conditions. The idea that this cannot be done, or that some special difficulties stand in the way, or that the problem is being prematurely presented, or that for some reason we can escape immediate action upon it, has been dispelled by the events of the past two years. It must be evident to all that the present moment is one which calls for the exercise of constructive business ability and the display of enterprise and initiative by our people along every line that experience shows to be required in facilitating the growth of business.

The fact that there has been so little genuine pioneer work in the direction of foreign trade is not a reflection upon the federal reserve system, but is merely an indication that American bankers and business men have not as yet aroused themselves to the real facts regarding our foreign trade situation. Yet it is evident that they must so arouse themselves and that their interest must become active and vigorous if the system itself is really to succeed. One of its great functions, as we have already seen, is that of establishing a discount market. Yet no such market can be successful unless it is given an international scope. The action of the Federal Reserve Board in establishing certain agencies or connections with foreign banking institutions is helpful as far as it goes, but cannot, of course, attain its full object unless genuine participation in foreign finance is undertaken by American institutions.

## VI

Brief reference has been made at various points in the foregoing discussion to the earnings of federal reserve banks. To the close of the year 1915 these earnings were about 3 per cent on capital above expenses, while for the year 1916 they were about 5 per cent. The returns thus obtained have been secured through the employment of only a small portion of the resources of the banks, and experience has made it evident that there will ordinarily be no trouble whatever in paying expenses and an excess above the 6 per cent which the banks may under the law retain for themselves. The question of earnings, however, is of very much broader significance than has ordinarily been conceded. As the federal reserve system grows older it becomes more and more evident that the

great question for it to settle is whether it is an emergency system or whether it is an integral part of the financial mechanism of the country. The great central banks of Europe are the leaders of the financial markets of their respective countries and the commanding factors therein. The legislative proposals which preceded the Federal Reserve act were framed upon an entirely different theory. They conformed to the remedial measures that had been suggested for a quarter of a century previous, and like them, were based upon the view that legislation should be of an emergency character. The bank desired emergency relief from the bad results of inflation, panic, or disaster. The Federal Reserve act was not confined, however, to the satisfying of such a demand. It created a permanent and costly organization; it provided regular and sustained functions which must be continuously performed in order to render the system efficient; it looked to regular rediscount transactions, not merely as a means of paying its expenses and dividends but as an indispensable medium through which to affect rates of interest and lending conditions. For all these reasons it was expected to play an active and important part in the market. This, however, it has not as yet succeeded in doing. Rediscount operations with it have been small, largely because of the great ease of money the country over. In order to sustain itself and to exert the influence it was expected to have, the system has, therefore, been obliged to operate under its open market powers. Of a total investment of about \$740,000,000 for the year ending December 31, 1916, 52 per cent consisted of bankers' acceptances and 12 per cent of warrants. Only 28 per cent consisted of rediscounted paper, while, of the bankers' acceptances thus held, a considerable part were the so-called renewal acceptances. It must be concluded from this that the field of activity in which the reserve system has thus far exerted itself has not been a broad one, and the question may fairly be asked how much it will be broadened in the future. Although specific provision was made in the Reserve act for direct dealings between federal reserve banks and individuals in case of necessity, practically none such have ever been undertaken, and some of the reserve banks even go so far as to decline to deal with an individual, even though he bring to them paper with the acceptance or endorsement or both of a member bank. They prefer to obtain their open market paper through brokers, and they abstain from any direct relationship with the business community. This policy is

in pursuance of the feeling that a plan of rigid separation between the reserve bank and the public will be more acceptable to member banks than one of close relationship, and the question is properly and pointedly asked whether the reserve system can succeed upon these lines. The answer undoubtedly depends upon the extent to which the member banks are willing to foster it and the volume of business which they permit to come to it. Should the system persevere in the view that for reasons of policy it is not wise to become active in the open market as a competitor of any bank, its field of operations will be confined to that which is allotted to it by the banks. Its popularity will be developed, moreover, only among the banks, since the business man will find himself entirely divorced from it save in so far as he may realize the effect of its indirect working. It is, therefore, fair to say that up to date the federal reserve system has not incorporated itself into the business life of the community and that it is still to be seen how far it will do so. Whether it is desirable that the system should be thus closely allied to the commercial world or not is a matter about which opinions evidently differ, but there is unquestionably a distinct body of opinion holding that a reasonable and direct relationship to the business community would strengthen not only the federal reserve system in the narrow sense of the term, but also its individual members. The settlement of this difference of opinion is perhaps the greatest problem by which the system today is confronted.

## VII

It may be worth while to draw together, in a brief summary, the conclusions of the foregoing discussion. The federal reserve system has accomplished the following results:

1. It has successfully organized and set in operation a plan of coöperative banking in each of the twelve districts comprising the continental United States.

2. It has successfully established and organized at Washington a central supervisory agency entitled the Federal Reserve Board.

3. The banks and the board have been, on the whole, efficiently and satisfactorily operated.

4. Under this organization interest rates have been harmonized and unified to some extent, currency demands have been readily and effectively met, crop-moving difficulties have been made to disappear, and generally harmonious action conveying all of the

benefits of centralized banking, and free of many of the demerits of that plan, has been the order of the day. Seasonal shipments of currency have been rendered unnecessary.

5. The federal reserve system has made decided and satisfactory progress toward the unification of the underlying banking resources of the country, and the accumulation of its gold reserves under uniform control.

The federal reserve system has undertaken several important pieces of work which are still incomplete:

1. It has begun the standardization and unification of the commercial paper of the country. Some progress has been made in this direction, but what has been done has been primarily educational, and thus far only secondarily practical.

2. An effort has been made to introduce new kinds of paper, notably the bankers' acceptance. With the aid of unusual financial conditions marked progress has been obtained, but this progress has been to some extent vitiated through the adoption of irregular or unusual expedients.

3. The federal reserve system has undertaken the establishment of a uniform and universal system for the collection of checks. It has succeeded in establishing such a system, and has been successful in eliminating some of the dangers arising from the artificially stimulated "float" which was carried by many banks in former times. It has rendered the task of check collection cheaper than formerly. A part of the benefits, but not all, have been transferred to the public. It will be necessary to have more coöperation from banks and clearing houses before the plan is wholly successful.

4. The federal reserve system has endeavored to make a beginning at standardizing methods of business accounting and securing the rendering of uniform statements, which so far has been only partially successful.

There still remain to be accomplished (in addition to the continuation of development along the lines set forth above) certain tasks which may be enumerated as follows:

1. Exploitation of the foreign banking field and the introduction of satisfactory measures looking to the retention of the foreign trade.

2. Development of the foreign relationships of federal reserve

banks themselves, which are thus far only tentative or rudimentary.

3. Creation and development of a general international discount market in which the United States should have a suitable share.

The reserve system is still laboring upon its underlying problem—that of making the system an integral factor in the financial life of the country, properly related to its business men and commercial enterprises, undertaking and performing within its own field regularly assigned functions, and serving the community not merely in “emergencies,” but as a permanent and trusted instrument.

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